No. 164

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

GRAHAM-PAIGE MOTORS CORPORATION,

Petitioner,

against

MICHAEL STELLA, suing in his own behalf and on behalf of all other stockholders of Kaiser-Frazer Corporation similarly situated,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR WRIT OF CERTIORARI TO UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner respectfully prays that a Writ of Certiorari issue to review the judgment of the Court of Appeals for the Second Circuit entered March 29, 1956, reversing the judgment of the United States District Court for the Southern District of New York entered on June 10, 1955, and remanding the action with directions to make an additional specific finding.

Opinions Below

The majority and minority opinions of the Court below are not yet reported, but are appended to this petition (pp. 9-18, infra. The opinion of the Trial Court is reported in 132 F. Supp. 100, and is printed in the appendix for

appellant filed herewith (pp. 39a-62a). The opinion rendered upon motion for summary judgment is reported in 104 F. Supp. 957, and is appended hereto (pp. 19 to 25, infra).

Grounds on Which Jurisdiction Is Invoked

The statutory provision believed to confer on this Court jurisdiction to review the judgment in question by Writ of Certiorari is United States Code, Title 28, § 1254(1). The date of the judgment sought to be reviewed and the time of its entry is March 29, 1956.

Questions Presented for Review

This action is brought by a stockholder of Kaiser-Frazer Corporation (hereinafter referred to as "K-F") under § 16(b) of the Securities Exchange Act of 1934 (15 U. S. C. 78p (b)) to recover short-swing profits allegedly made by Graham-Paige Motors Corporation (hereinafter referred to as "G-P") in the stock of K-F. G-P is claimed to have been an insider by reason of owning "more than 10 per centum" of the outstanding stock of K-F. The transaction involved in this case arose from the acquisition by G-P of 750,000 shares of K-F stock and the subsequent sale of 155,000 shares thereof.

Immediately prior to its acquisition of said 750,000 shares, G-P was the owner of only 6¼% of the outstanding stock of K-F. After such acquisition G-P was the owner of more than 10% of such outstanding stock.

Question One. Does this case come within the express statutory exception contained in § 16(b), that:

> "This subsection shall not be construed to cover any transaction where such beneficial owner was not such [owner of more than 10% of any class of any equity security] both at the time of the purchase and sale, or the sale and purchase, of the security involved. * * *"

Question Two. Does a "beneficial owner" become a wrong-doing fiduciary merely by buying and selling within a period of less than six months, or does he become such only after the plaintiff has sustained the burden of proving that such purchase and sale resulted in a profit.

The Statute Involved

"78p. Directors, officers and principal stockholders.

"(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security or within ten days after he becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

"(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding

six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Statement of the Case

Prior to February, 1947, G-P owned 250,000 shares of K-F common stock. 4,000,000 shares of K-F stock were then outstanding, so that the 250,000 represented only 6¼% thereof.

No other shares were acquired by G-P and no other shares were issued by K-F until G-P acquired an additional 750,000 shares in February, 1947. So that after that acquisition G-P owned 1,000,000 shares out of 4,750,000 shares outstanding, or about 21%.

After the acquisition aforesaid, G-P acquired no more K-F stock, but in August, 1947 (at a time which has been held to be within a period of less than six months from the date of acquisition) G-P sold 155,000 shares of K-F stock.

Therefore, G-P did not become a "beneficial owner" (an owner of more than 10% of the outstanding stock of any class of equity security of K-F) except as a result of the February, 1947 acquisition which has been used by the courts below as the purchase to be matched against the sale in August, 1947, to bring G-P within § 16(b).

Basis for Federal Jurisdiction in the District Court

The basis for Federal jurisdiction in the District Court is believed to be United States Code, Title 15, § 78 p. (b) and Title 28, § 1331.

Argument Amplifying the Reasons Relied on for the Writ

The Court below has decided important questions of federal law which have not been, but should be, settled by this Court.

Question One

Section 16(b) of the Securities and Exchange Act of 1934 (15 U. S. C. 78 p. (b)) contains the following specific exception:

> "This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, * * *."

Until G-P had acquired the 750,000 shares it was not an "insider" within the meaning of the Act. It made no subsequent acquisition of K-F shares.

Therefore, petitioner believes, that under the Act, it was not a "beneficial owner" or an "insider" at the time of purchase. Perforce, it was not such "beneficial owner" both at the time of purchase and sale, even though it concededly was at the time of sale.

The construction of the express language contained in § 16(b) and quoted above is that § 16(b) "shall not be construed" to cover any transaction where such beneficial owner was not such "both" at the time of the purchase and sale.

The lower courts have held that G-P was an insider "at the time" of the purchase because it became the owner of more than 10% of the outstanding stock of K-F as a result of such purchase.

Judge Hincks of the Court of Appeals dissented from this view and in his opinion (pp. 13-18, infra) said, "I think that the construction adopted by the court is in direct conflict not only with the simple language of the Act but also with its basic rationale and scheme."

The petitioner contends that it is of utmost public and general importance for this Court to decide whether a person who owns less than 10%, or even none, of any equity security of an issuer should be held to have been an owner of more than 10% "at the time" of the purchase by him of sufficient stock to bring his holdings over the 10% figure. It is the petitioner's further contention that one who owns less than 10% is not an "insider". And that if while he is not an insider, he buys sufficient stock to increase his holdings to more than 10%, it cannot be said that he made such purchase while he was an insider.

Question Two

The Court below has held that "under Section 16(b), a 'beneficial owner' who buys and sells within the statutory period is to be regarded as a fiduciary who breaches his duty of loyalty (i.e. his duty not to engage in self-dealing) and who, in such circumstances, must account for his profits."

Putting it differently, the Court below has held that a defendant is shouldered with the obligations of an unfaithful trustee upon proof of two facts: (1) that he is an insider and (2) that he bought and sold within a period of less than six months.

We contend that before a defendant in an action under § 16(b) can be found to be "a fiduciary who breaches his duty of loyalty" the additional fact must be proved that his dealing in the stock of the issuer resulted in a profit. Short-swing transactions by insiders are not condemned by the statute. It is only short-swing "profits" which vio-

late the statute. An insider may at any time, even within a period of less than six months, obtain a return of his investment in the issuer's stock. In fact this was within the contemplation of Congress when the law was enacted. See Hearing before Senate Committee on Banking and Currency S. 84, 72d Congress, 2nd Sess., and S. 56 and S. 97, 73rd Congress, 1st and 2nd Sess., 1934; Hearing before House Committee on Interstate and Foreign Commerce on H.R. 7852 and H.R. 8720, 73rd Cong., 2nd Sess., 1934.

Inasmuch as the law condemns only a short-swing profit by insiders, the plaintiff in an action under § 16(b) has the burden of proving not only the status of the defendant, and the short-swing nature of the transaction, but, also, that there was a "profit realized" by the defendant. A plaintiff has not proved any breach of fiduciary obligation on the part of a defendant until he has proved that a profit was in fact realized.

The Court below has erroneously held that if a plaintiff shows a short-swing transaction by an "insider" defendant, it is the burden of the defendant to show that the transaction did not result in a profit.

The petitioner believes that the burden of proving each necessary element of the asserted cause of action is upon the plaintiff who asserts it. (*Commercial Molasses Corporation* v. *New York Tank Barge Corporation*, 314 U. S. 104, 110, 111; 86 L. Ed. 89, 96).

WHEREFORE it is respectfully submitted that this petition for Writ of Certiorari to review the judgment of the Court of Appeals for the Second Circuit should be granted.

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Opinion of Court of Appeals and Dissenting Opinion of Circuit Judge Carroll C. Hincks

FRANK, *Circuit Judge*:

The facts are fully stated in the opinion of the district judge, reported in *Stella* v. *Graham-Paige Motors Corporation*, 132 F. Supp. 100.

1. The trial judge, we think correctly, adopted the reasoning of Judge Samuel Kaufman's decision, denying a summary Judgment, reported in 104 F. Supp. 957, in holding that Graham-Paige, for purposes of Section 16(b), became the "beneficial owner" of 10% of the Kaiser-Frazer stock at the very moment when Graham-Paige purchased that stock. Before Judge Kaufman, the S. E. C. filed a brief as *amicus curiae* in support of what became Judge Kaufman's interpretation.

2. We agree with the trial judge that the purchase of the stock occurred on February 10, 1947, and that therefore sales made before August 8, 1947 were within the statutory period. The date when a purchaser becomes a "beneficial owner" is that on which he "incurred an irrevocable liability to take and pay for the stock," when his "rights and obligations became fixed." *Blau* v. *Ogsbury*, 210 F. 2d 426, 427 (C. A. 2). Here Graham-Paige was to pay, in part, $3,000,000 in cash. It did not have that sum when the contract with Kaiser-Frazer was made but in the contract agreed to use its best efforts to borrow that sum from a certain bank in accordance with a letter agreement. This letter agreement provided that the bank's obligation to make the loan was on condition that the Henry J. Kaiser Company would guaranty it. The agreement with Kaiser-Frazer provided, in effect, that, if Graham-Paige was unable to obtain the loan from the bank in accordance with

the letter agreement, Graham-Paige had the election to terminate the agreement with Kaiser-Frazer. As the trial judge said: "There is no evidence that the Henry J. Kaiser Company became bound to execute the guaranty at any time before the closing meeting on February 10, 1947, when it did so." It follows that, until that date, Graham-Paige had not incurred "an irrevocable liability to take and pay for the stock." [1]

In *Blau* v. *Ogsbury, supra,* the question was when the holder of an option to buy stock became the "beneficial owner." We held that it was not (a) the date when he acquired the option, nor (b) the day when, having exercised it, he paid for the stock and obtained legal title to it, but (c) the day when he exercised the option with the result that he had then a fixed right and obligation under an executory contract. See also *Park & Tilford* v. *Schulte,* 160 F. 2d 984, 987 (C. A. 2) where we said that, upon the exercise of an option, the optionee becomes an "insider" and thus within the Congressional purpose to "protect the outside stockholders against at least short-swing speculation by insiders with advance information." Our reasoning was that one who holds an unexercised option it not usually in a position to obtain such information from the company. Here Graham-Paige, as long as it had an election to back out of the agreement to purchase, was not an "insider" under Section 16(b). That election continued until the

[1] Defendant argues that the word "purchase" in Section 16(b) must be defined according to Section 3(a)(12) which provides, "When used in this chapter, *unless the context otherwise requires* * * * the terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire." The words we have italicized destroy defendant's contention. For the relevant portion of Section 16(b) deals with a person who is directly or indirectly "the beneficial owner" of more than 10% of any class of any registered equity security. Since Graham-Paige was not irrevocably bound to purchase until February 10, 1947, it was not previously the "beneficial owner," directly or indirectly.

Henry J. Kaiser Company signed the guaranty of the loan on February 10, 1947.[2]

3. The trial judge found—we think correctly—that Graham-Paige's statements of profit in the amount of $434,787.86 sufficed to establish a prima facie case for plaintiff. Significantly, the judge refused to make a finding, requested by defendant Graham-Paige, that there were no profits. But the judge apparently assumed that plaintiff, despite his prima facie case, continued to bear the burden of proving that there were profits and in what amount; therefore, as defendant's proof left the judge uncertain in this respect, he decided for the defendant. So we incline to understand the judge's reasoning as indicated, *e.g.*, by his statement that, "Plaintiff's prima facie proof * * * has been shown to be unacceptable."

If so, we think the judge erred. In *Gratz* v. *Claughton*, 187 F. 2d 46 (C. A. 2) we held that, under Section 16(b), a "beneficial owner" who buys and sells within the statutory period is to be regarded as a fiduciary who breaches his duty of loyalty (*i.e.* his duty not to engage in self-dealing)

[2] The S. E. C.'s position on when a person becomes a "beneficial owner" by the purchase of stock coincides with our interpretation. In an opinion, the General Counsel stated:

> "In my opinion an officer, director or stockholder is to be deemed to have acquired beneficial ownership of a security at the time when he takes a firm commitment for the purchase thereof, and to divest himself of such beneficial ownership at the time when he takes a firm commitment for the sale thereof. If it is necessary that certain conditions be satisfied prior to the consummation of the purchase or sale, and if it is uncertain whether such conditions will be satisfied, then it would appear that the officer, director, or stockholder would not acquire beneficial ownership, or divest himself thereof, until such time as such conditions are satisfied and the undertaking to purchase or sell becomes a firm commitment." 11 Fed. Reg. 10968 (1946). See also, Cook and Feldman, Insider Trading Under the Securities and Exchange Act, 66 Harvard L. Rev. 385, 401-402; Rubin and Feldman, Statutory Inhibitions Upon Unfair Use of Corporate Information by Insiders, 95 U. of Pa. Law Rev. 468, 481-492 (1947).

and who, in such circumstances, must account for his profits. Elsewhere we have held that, once a cestui shows a breach of such a duty and prima facie proof of a maximum amount of profits made by the fiduciary, then the fiduciary has the burden of proving to what extent the profits were less than this maximum—especially where the fiduciary's breach is responsible for the difficulty or impossibility of proving the amount with certainty—and that consequently, if the fiduciary's proof leaves the amount uncertain, judgment goes against him for the maximum figure. See *Perlman* v. *Feldman*, 219 F. 2d 173, 177, 178 (C. A. 2); *York* v. *Guarantee Trust Co. of New York*, 143 F. 2d 503, 517 (C. A. 2); *Phelan* v. *Middle States Oil Corp.*, 220 F. 2d 593, 600-601, 613 (C. A. 2); *President and Directors of Manhattan Company* v. *Kelby*, 147 F. 2d 465, 476 (C. A. 2); *Upson* v. *Atis*, 155 F. 2d 606 (C. A. 2); cf. *Bigelow* v. *R. K. O. Pictures*, 327 U. S. 251, 265-266; *Story Parchment Co.* v. *Paterson Parchment Co.*, 282 U. S. 555; *Package Closure Corp.* v. *Seabright Corp.*, 141 F. 2d 972, 979 (C. A. 2).[3]

However, since it is not entirely clear what the judge would have found—as to whether Graham-Paige discharged its proof-burden—had he read the foregoing, in the interest of justice we remand with directions that he make a specific finding on that issue, in the light of what we have said above.[4]

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[3] The judge ruled that, because there could be but one buyer of the Graham-Paige assets, the willing-seller-willing-buyer rule of fair market value was inapplicable. Perhaps we need not consider that ruling in view of the ground of our decision. But it may be well to say that we think this ruling erroneous. The willing-seller rule is not abrogated by the absence of a market; the trier of the facts must look to other relevant evidence of the price which a buyer would pay. See *United States* v. *Toronto Nav. Co.*, 338 U. S. 396, 402; *United States* v. *Miller*, 317 U. S. 369, 374-375; *De La Roma S.S. Co.* v. *United States*, 206 F. 2d 651, 655 (C. A. 2); *Westchester Park Comm.* v. *United States*, 143 F. 2d 688, 692 (C. A. 2).

[4] If, on the basis of such a finding, Graham-Paige is liable, interest should be added from the date of sale. See *Beau* v. *Mission Corp.*, 212 F. 2d 77, 82 (C. A. 2).

HINCKS, Circuit Judge (dissenting):

I would affirm on the ground that the defendant's purchase and sale of Kaiser-Frazer stock was a transaction not within the scope of § 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A. 78p(b).*

Immediately prior to its purchase of 750,000 shares of this stock the defendant was the owner of only 6¼% of the outstanding stock.** At that time, therefore, the defendant was not a "beneficial" owner within the meaning of § 16(a) of the Act wherein a "beneficial owner" is defined as a person who owns "more than 10 per centum of any class of any equity security * * *." So far there is no dispute. Section 16(b) reaches only the "profit realized by him [*i.e.*, the beneficial owner] from any purchase and sale of any equity security * * *." Since profit on pur-

* Section 16(b) of the Securities Exchange Act of 1934 provides:

"For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

** See *Stella* v. *Graham-Paige Motors Corp.*, 104 F. Supp. 957.

chased stock is not "realized" until its sale, this—the operative clause of the Section—standing alone might be read as applying to profit realized by a person who was a "beneficial owner" at the time of his sale, irrespective of his status as a beneficial owner at the time of his prior purchase of the stock. Apparently because it recognized that this might be taken as the meaning of the operative clause, Congress added a final sentence to § 16(b), shown in the text of the Section as printed in an earlier footnote, wherein it gave its own construction of the operative clause. It there said that the subsection "shall not be construed to cover any transaction where such beneficial owner was not such *both at the time of the purchase and sale* * * *." Although Congress did not supply the typographical emphasis appearing above, its language, especially when read in connection with the operative clause, plainly showed that it did in fact emphasize the very phrase that I have italicized. Thus in plain unambiguous language Congress said that the section does *not* apply to this defendant who though a beneficial owner at the time of sale "was not such both at the time of the purchase and sale."

I cannot go along with my brothers who adopt the reasoning and ruling of Judge Kaufman's opinion reported in 104 F. Supp. 957 which Judge Dimock took as stating the law of the case. In that opinion, it was said that "there is ambiguity" in the exclusionary sentence quoted above and, later, that the alleged ambiguity was located in the phrase "at the time" This simple phrase was thought to afford a choice between two constructions, *viz.*: "prior to" on the one hand, or "simultaneously with" on the other hand. My brothers approve Judge Kaufman's choice of the latter "construction" On that basis they hold the transaction here involved to come within § 16(b). They thereby seem to commit the court to one or the other of these two propositions: (a) that any purchase by an outsider of a 10% interest in a stock equity gives rise to a conclusive presumption that the purchaser had inside information as to

the affairs of the corporation, or (b) that a sale for profit by a "beneficial owner" of stock in his corporation may give rise to a conclusive presumption of a breach of fiduciary duty even though the seller was under no fiduciary duty at all when he had previously purchased the stock sold. Quite independent of my difficulty in believing that Congress could have intended to subject "beneficial owners" to conclusive presumptions of such drastic scope, I think that neither of the propositions posed above are tenable. For the simple language which my brothers find ambiguous is to me crystal clear. The grammar would have been better, but the meaning no clearer, if it had read "at the time both of the purchase and of the sale." Nobody points to other provisions of the statute or to anything in its legislative history which conflicts with the plain meaning.

To give any other "construction" to such language is, in my opinion, to attribute to Congress an intent at variance with that to which it gave expression. In the face of such clear language there is no need for courts to plumb the depth of the collective legislative mind and no power in the courts to adjust the expressed intent of Congress to its supposed objective. In the case of *Lake County* v. *Rollins*, 130 U. S. 662, it was said, " * * * where a law is expressed in plain and unambiguous terms, whether those terms are general or limited, the legislature should be intended to mean what they have plainly expressed, and consequently no room is left for construction." In *Packard Motor Company* v. *Labor Board*, 330 U. S. 485, the court said, " * * * it is for Congress, not for us, to create exceptions or qualifications at odds with its plain terms. * * * However we might appraise the force of these arguments as a policy matter, we are not authorized to base decision of a question of law upon them. They concern the wisdom of the legislation; they cannot alter the meaning of otherwise plain provisions." See also *Ex parte Collett*, 337 U. S. 55; *Helvering* v. *City Bank Company*, 296 U. S. 85; and *Osaka Shosen Kaisha Line* v. *United States*, 300 U. S. 98.

The opinion below cites *United States* v. *C. I. O.*, 335 U. S. 106, wherein it was held that the word "expenditure" as used in § 304 of the Labor Management Relations Act of 1947 should be interpreted in the light of the Congressional purpose. But that was because the word "has no definitely defined meaning." Also cited was *S. E. C.* v. *Joiner Corp.*, 320 U. S. 344, for the proposition that "the purpose of Congress is a dominant factor in the determination of a statute's meaning * * * and *where a choice may be made between two possible constructions*, that construction should be chosen which would serve to effectuate Congressional purpose rather than defeat it." (Emphasis supplied.) There the problem was whether the transaction in question came within the phrases "an investment contract" or "in general any interest or instrument commonly known as a security" as used in the definition of "security" in § 2(1) of the Securities Exchange Act, 15 U. S. C. A. 77b(1). The court spoke of these definitions as being "of variable character" and "descriptive terms" which required interpretation "in conformity with its [the] dominating general purpose" of the Act. That case, too, I think not apposite here. For the exclusionary sentence of § 16(b) did not provide "two possible constructions," nor were its provisions couched in "descriptive terms" of "variable character."

My brothers' "construction" is apparently chosen because thought to be more consonant with the Congressional purpose "to protect the outsider stockholders against at least short-swing speculation by insiders with advance information." *Shaw* v. *Dreyfus*, 2 Cir., 172 F. 2d 140; *Park & Tilford Inc.* v. *Schulte*, 2 Cir., 160 F. 2d 984. I accept, of course, this statement of the Congressional purpose. Notwithstanding, I think that the construction adopted by the court is in direct conflict not only with the simple language of the Act but also with its basic rationale and scheme.

By the Act, Congress recognizes that officers and directors of a corporation generally have access to advance information as to its condition and prospects which when released

to the public may sharply affect the market value of its stock. It seeks to hold these fiduciaries accountable to the corporation for personal profits made by them through trading in its stock *on the basis of such advance information.* And so, in recognition of the difficulty of proving that they actually had advance information which actuated their trading, the Act conclusively presumes that one who, while an *officer or director*, makes both a *purchase and sale* within so short a period as six months was actuated by advance information actually received. Congress recognized further that large stockholders also often have a dominant voice in management and hence have access to advance information. Such stockholders, as well as officers and directors, thus have the qualifications of "insiders." Consequently, Congress adopted a provision whereby those owning 10% or more of the stock should as "beneficial owners" be included amongst the insiders, apparently thinking that provision to be at least roughly consonant with the realities of intracorporate relationships and desirable in that it would serve as an accurate definition of the class adequate for the guidance of the commercial public, and would facilitate the proofs necessary for enforcement litigation under the Act.

But the basic rationale of the Act was such that only completed swing transactions gave rise to the presumption of unethical use of advance information: if one purchased stock on one day, became a director on the next, and sold some of his stock on the next, any resulting profit was not recoverable by the corporation apparently because a sale alone was thought to be insufficient basis for a drastic presumption that it had been made in violation of a fiduciary duty. In principle, the same rationale is equally applicable to beneficial owners who do not become such until a given purchase is consummated. Under that rationale, the presumption will arise only when both the purchase and the sale were made by one who at the time was a fiduciary.

It is true that if the Act gives consistent effect to this rationale, it makes it possible for one who actually had

advance information but was not a beneficial owner at the time of his purchase, to evade the Act, as was observed by Judge Kaufman in his opinion below. And under the same rationale, it excludes from accountability persons, like the defendant here, who until their purchases were consummated lacked even access to advance information. On the other hand, the Act, under my brothers' "construction" sanctions one or both of the propositions stated in an earlier paragraph of this opinion.

It was of course for Congress, not the courts, to weigh the conflicting policies affecting the scope which it should give to the Act. It decided to bring "beneficial owners" within the Act. But the extent to which they should be held accountable was unmistakably indicated by the final exclusionary sentence of § 16(b). It obviously thought it better, at least for the time being, to leave in the Act a loophole for some who, under the basic rationale, deserved to be held to accountability, than to suck into a suffocating dragnet many who, under the same rationale, could not justly be so held.

Opinion of Trial Judge Edward J. Dimock Reported at 132 F. Supp. 100

(Printed in Appendix for Appellant in Court of Appeals, filed herewith, at pages 39a-62a.)

Opinion of District Judge Samuel H. Kaufman on Motion for Summary Judgment, Reported at 104 F. Supp. 957

SAMUEL H. KAUFMAN, *D. J.*:

Plaintiff, a stockholder of Kaiser-Frazer Corporation, sues Graham-Paige Motors Corporation to recover profits realized by said defendant upon the purchase and sale within less than six months of 155,000 shares of Kaiser-Frazer stock (§ 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78p(b)), and said defendant moves for summary judgment or for judgment on the pleadings.

The complaint, filed on July 26, 1949, alleges in substance that on February 10, 1947, Graham-Paige purchased 750,000 shares of the common stock of Kaiser-Frazer; that by said purchase, Graham-Paige became the beneficial owner of more than 10% of Kaiser-Frazer common stock, since there were 4,750,000 shares of such stock then outstanding; that within less than six months from the date of the purchase of the 750,000 shares, Graham-Paige sold 155,000 of said shares and realized a profit from such sale in excess of $434,787.86; that because of the provisions of the Securities Exchange Act of 1934, 15 U. S. C. A. § 78a et seq., the profit realized by Graham-Paige is recoverable by Kaiser-Frazer; that plaintiff's written request to Kaiser-Frazer that it bring an action to recover said profits was rejected with the statement that if plaintiff desired to bring suit, Kaiser-Frazer would have no objection because the sixty-

day period of notice to the corporation provided by § 16(b) had not yet expired; wherefore plaintiff prays that Kaiser-Frazer recover judgment against Graham-Paige for the profits realized from the transaction with interest, costs, disbursements and reasonable attorneys' fee.

The answer of Graham-Paige admits the acquisition of more than 750,000 shares of Kaiser-Frazer common stock; admits that on February 10, 1947, Kaiser-Frazer had outstanding 4,750,000 shares of common stock, and that on that date Graham-Paige owned more than 750,000 shares of said stock; admits ownership of more than 10% of the stock, and that 155,000 shares were sold by it; admits that in certain of its records a profit item of $434,787.86 appeared, based upon values assigned for such stock, but denies that any profit was realized from the acquisition and sale of that stock.

From the affidavits and exhibits filed in this proceeding, it appears that Kaiser-Frazer Corporation, upon its organization in 1945, had a capital structure consisting of 500,000 shares of common stock. Of these shares, 250,000 were issued to Graham-Paige and 250,000 to interests controlled by Henry J. Kaiser. On September 26, 1945, an issue of 1,700,000 new shares of Kaiser-Frazer stock was sold to the public, diluting the ownership of Graham-Paige and the Kaiser interests so that each owned 11.34% of the outstanding stock. An additional issue of 1,800,000 new shares was sold to the public on January 23, 1946. Prior to and up to the time of this sale, Graham-Paige still retained 250,000 shares, or 11.34% of the outstanding stock, while the holdings of the Kaiser interests had increased to 325,000 shares, or 14.77% of the stock outstanding. The result of the public sale of 1,800,000 shares on January 23, 1946 was to reduce Graham-Paige's holdings to 6¼% of the outstanding shares. The Kaiser interests acquired on such public offering an additional 45,000 shares, thereby increasing its ownership to 370,000 shares, or 9.25% of the shares outstanding. The purchase of 750,000 shares by Graham-

Paige on February 10, 1947, which increased its holdings to 21%, was in pursuance of an agreement under which these shares were placed in a voting trust of which Kaiser and Joseph W. Frazer, an officer of Graham-Paige, were the voting trustees. The sale of the 155,000 shares, the transaction out of which this suit arose, occurred on August 9, 1947.

The problem presented by this motion is one of novel impression, the solution of which is dependent upon the interpretation of § 16(b) of the Securities Exchange Act of 1934. Section 16(b) provides:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

The phrase "such beneficial owner" in the first sentence of § 16(b) refers to § 16(a) which declares:

> "Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange * * *."

Gratz v. *Claughton*, 2d Cir. 1951, 187 F. 2d 46; *Park & Tilford, Inc.* v. *Schulte*, 2d Cir. 1947, 160 F. 2d 984.

Graham-Paige contends that the purchase and sale involved in this action were exempt from the sanction imposed by § 16(b) because it was not the beneficial owner of more than 10% of Kaiser-Frazer stock both at the time of purchase and sale. Plaintiff argues that the exemption contained in the last sentence of § 16(b) is inapplicable to the present transaction, a view which finds support in the brief filed by the Securities and Exchange Commission as *amicus curiae*. Plaintiff further declares that the close relationship between Graham-Paige and the Kaiser interests was such as to constitute them collectively a "person" within the meaning of § 3(a)(9) of the Securities Exchange Act of 1934, 15 U. S. C. A. § 78c(a)(9), and that, therefore, Graham-Paige was actually the beneficial owner of more than 10% of Kaiser-Frazer stock before February 10, 1947.

There is an ambiguity in the exemption provision of § 16(b). It declares:

> "This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved * * *."

Do the words "at the time" mean "prior to", which is the contention of defendant Graham-Paige, or do they mean "simultaneously with", the theory advanced by plaintiff and the Securities and Exchange Commission?

The purpose of Congress is a dominant factor in the determination of a statute's meaning. *United States* v. *C.I.O.*, 1948, 335 U. S. 106, 112, 68 S. Ct. 1349, 92 L. Ed. 1849, and where a choice may be made between two possible constructions, that construction should be chosen which would serve to effectuate Congressional purpose rather than defeat it. "However well [rules of statutory interpretation] may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy." *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corp.*, 1943, 320 U. S. 344, 350-51, 64 S. Ct. 120, 123, 88 L. Ed. 88.

Although the legislative history of § 16(b) fails to afford a clue as to the precise meaning of the words "at the time", the Congressional purpose underlying the enactment of this section is clear. It was "to protect the outside stockholders against at least short-swing speculation by insiders with advance information." *Shaw* v. *Dreyfus*, 2d Cir. 1949, 172 F. 2d 140, 142; *Park & Tilford* v. *Schulte*, *supra*, 16 F. 2d at 987.

If the construction urged by defendant is placed upon the exemption provision, it would be possible for a person to purchase a large block of stock, sell it out until his ownership was reduced to less than 10%, and then repeat the process, ad infinitum. A construction such as this would provide a way for the evasion of § 16(b) by principal stockholders, and render it largely ineffective to prevent some of the financial evils which led to the passage of this legislation by Congress.

Conversely, if the words "at the time" are construed to mean "simultaneously with", a shareholder would become subject to the provisions of § 16(b) as soon as his ownership exceeded 10% of the outstanding shares. This con-

struction would be consistent with the declared purpose of the statute to prevent the unfair use of inside information by officers, directors, or stockholders owning more than 10% of the equity stock.

Assuming that a shareholder becomes subject to the liability imposed by the statute immediately upon becoming the owner of more than 10% of the equity shares of a corporation, it would appear that the exemption provision was intended "to exclude the second sale in a case where 10% is purchased, 5% sold within three months and the remaining 5% a month later." Seligman, Problems Under the Securities Exchange Act, 21 Va. L. Rev. 1, 20 (1934).

The construction of a statute by an agency charged with its administration is entitled to great weight. *United States* v. *American Trucking Association*, 1940, 310 U. S. 534, 549, 60 S. Ct. 1059, 84 L. Ed. 1345, and the Securities and Exchange Commission maintains that it has consistently regarded the purchase by which a shareholder achieved a 10% interest in the corporation as bringing him within the purview of § 16(b). To support this contention it cites Rule NB2, 17 Code Fed. Regs. § 240.16b-2 (1949), which exempts certain underwriting transactions from the effect of the statute. This exemptive rule, it reasons, would not have been necessary unless § 16(b) were construed by the Commission to apply to a shareholder immediately upon acquiring more than 10% of a corporation's stock. While this is not a conclusive demonstration that the Commission so interpreted the statute, it may be observed that the likelihood that this construction of the exemption provision of § 16(b) would constitute a bar to the underwriting of stock, was pointed out shortly before the adoption of the first version of the Rule in 1935.[1]

[1] See Seligman, *loc. cit. supra* at 20: "Attention should be called to the fact that under this construction of the Act, unless and until the Commission issues rules to the contrary, a bar to any substantial stock financing is created if the stock is registered."

Because the interpretation of the statute advocated by plaintiff and the Commission is accepted, it is unnecessary to decide whether or not a genuine issue of fact is created by the contention that defendant Graham-Paige owned more than 10% of Kaiser-Frazer stock prior to February 10, 1947.

Motion denied. Settle order on notice.

May 13th, 1952.

/s/ SAMUEL H. KAUFMAN,
United States District Court.

Judgment

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 29th day of March one thousand nine hundred and fifty-six.

Present: HON. CHARLES E. CLARK,
Chief Judge,
HON. JEROME N. FRANK,
HON. CARROLL C. HINCKS,
Circuit Judges.

MICHAEL STELLA, etc.,
Plaintiff-Appellant,

v.

GRAHAM-PAIGE MOTORS CORP., and KAISER-FRAZER CORP.,
Defendants-Appellees.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed and action remanded in accordance with the opinion of this Court; with costs taxed in favor of appellant.

A. DANIEL FUSARO,
Clerk.

FILED
JUL 13 1956
JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 164

GRAHAM-PAIGE MOTORS CORPORATION,

Petitioner,

—against—

MICHAEL STELLA, etc., *et al.*,

Respondents.

BRIEF OF RESPONDENT MICHAEL STELLA IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Statement

This is an action to recover short-swing profits realized by Graham-Paige Motors Corporation (G-P) from the purchase and sale within less than six months of shares of stock of Kaiser-Frazer Corporation (K-F) in violation of Section 16(b) of the Securities Exchange Act of 1934 prohibiting short-swing profits by corporate insiders—officers, directors or beneficial owners of more than 10% of the outstanding stock.

G-P and the Kaiser interests promoted K-F and each subscribed to and acquired 50% of its originally issued stock. Frazer was President of both G-P and K-F, and Kaiser was Chairman of the K-F Board. In addition G-P and K-F became engaged in a joint manufacturing operation in which both produced automobiles on the same assembly line with the same labor, allocating capital and operating expense in proportion to the cars produced for each (3a-5a).[1] Successive sales to the public of additional shares reduced the G-P interest in K-F to 6¼% and the Kaiser interest to 9¼% without affecting the joint control of K-F or the joint operation above mentioned. At this point K-F issued an additional 750,000 shares of its stock to G-P in exchange for G-P's share of the jointly operated automotive assets, which brought its interest in K-F to over 21% (Pet. pp. 20, 21).[2] Within less than six months G-P sold 155,000 shares of this stock realizing a substantial profit which the Court of Appeals held recoverable by the respondent stockholder of K-F for K-F's benefit.

Petitioner's *Question One* is based on its assertion that it was not, as the statute requires, a beneficial owner of more than 10% of K-F's stock "both at the time of the purchase and sale". According to the literal language of the statute petitioner *was* a beneficial owner of over 10% "at the time [i. e. the precise instant] of the purchase" which brought its interest to over 21%; although the moment before

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[1] References (— a) are to respondents' appendix in the Court of Appeals now filed in this Court.

[2] Some of these circumstances are noted in the brief *amicus* of the Securities and Exchange Commission in the District Court when petitioner moved for summary judgment on its *Question One* (Pet. p. 2). The SEC brief is attached hereto as Appendix A.

the purchase petitioner owned less than 10%. Judge Kaufman and a majority of the Court of Appeals construed "at the time" as meaning "simultaneously with" (Pet. pp. 23, 24) or "at the very moment" of the purchase (Pet. p. 9). Judge Hincks dissented on the ground that "at the time" cannot possibly mean "simultaneously with" (Pet. pp. 14, 15), particularly in the case of persons "like the defendant here, who until their purchases were consummated lacked even access to advance information" (Pet. p. 18). As shown *supra*, p. 2, Judge Hincks was in error in believing that petitioner was in this category.[3]

Petitioner's *Question Two* is based upon an erroneous statement of the holding of the Court of Appeals, and simply is not presented at all (see pp. 7-9, *infra*).

The Petition

The reason asserted by Petitioner for granting the writ is that the Court of Appeals decided two important questions of federal law which have not been but should be settled by this Court. Petitioner is in error. One of these questions has been repeatedly

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[3] The administrative experience of the Securities and Exchange Commission, as indicated in Appendix A herewith, pp. 11-20 below, indicates that a purchaser of a large block usually has prior inside information:

> "• • • A person who acquires a large block of stock in a single transaction normally has access to inside information. He necessarily would deal, in the negotiations looking toward the purchase, with either the issuer or an insider holding a large interest in the issuer. In either event he would be in a position to bargain for disclosures not available to the public. It is against abuse of information so obtained as well as of information obtained after representation in management is secured that the section is directed."

decided by this Court in accordance with the decision below; and the other rests on the application of principles likewise repeatedly decided by this Court and not questioned by Petitioner.

First Reason for Review

The first reason assigned is that the Court below construed "at the time" of the purchase as meaning "at the very moment" (Pet. pp. 5, 6, 9). The Court below did so construe these words; but such construction is required by the grammatical meaning and context as well as by the legislative purpose and history and the prior administrative construction.

1. Petitioner's entire argument proceeds, as does the opinion of Judge Hincks, from the premise that "at the time" cannot possibly mean "at the very moment" or "simultaneously with" but must mean "prior to" (Pet. p. 14). Hence, the language being unambiguous there is no reason for recourse to legislative purpose and history and prior administrative construction. Petitioner's assertion—though contrary to the conclusion of four judges below—is unsupported by citation of any dictionary or court authority; and such authority is against Petitioner.

The three standard dictionaries (Webster's, Funk & Wagnall and the New Oxford Dictionary) make it clear that "time" may mean, according to the context, an instant or a longer period. As Webster says, "time" means "the point or period when something occurs". As the New Oxford Dictionary says "The 'point' may be an instant (as the 'time' when a star crosses the meridian) or it may have some duration

(as the time for sowing)." Accordingly whether the "time" of an occurrence is a moment or a longer period must be judged by the nature of the occurrence. If the occurrence is the acquisition of title to stock, which the law considers as taking place in a single instant then "at the time" of such acquisition means at that very instant.

An example of such a construction is afforded by *Castle* v. *Castle*, 9 Cir., 267 Fed. 521, 522. Here the question was whether a widow was entitled to one-third of the proceeds of life insurance policies payable to her husband's estate under a statute of Hawaii which provided that she was entitled by way of dower to one-third of the husband's personal property "in possession or reducible to possession at the time of his death". The Supreme Court of the Territory held that the right to the money due on the policy did not accrue until after death; hence the widow did not take. The Court of Appeals reversed holding "The wife becomes a widow *at the instant* that the husband is dead, and that *at that instant* her right becomes consummate. *Randall* v. *Kreiger*, 90 U. S. (23 Wall.) 137, 23 L. Ed. 124. The policies of insurance became payable *at the instant that death occurred.*" (Emphasis ours.)

Accordingly we submit that "the time of purchase" is the precise instant of its occurrence; and to construe the phrase as meaning *before* the purchase is a forced and unnatural construction.

With the collapse of Petitioner's assumption that "at the time" necessarily means "before" and cannot grammatically mean "simultaneously with" or "at the very moment" of the purchase, this case presents merely the application of well settled rules of con-

struction repeatedly approved by this Court in cases cited by Judge Kaufman (Pet. pp. 23, 24).

> *United States* v. *C. I. O.*, 335 U. S. 106, 112;
> *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corporation*, 320 U. S. 344, 350-1;
> *United States* v. *American Trucking Association*, 310 U. S. 534, 549.

Such a case does not merit review.

2. The brief *amicus* of the Securities and Exchange Commission before Judge Kaufman below, Appendix A hereto, clearly shows:

> (a) that one of the examples of abuse by insiders presented to Congress was a case similar to that of petitioner, which would not be covered by Section 16(b) of the Act if petitioner's construction were adopted,
>
> (b) that immediately after adoption of the Act the Commission adopted a rule exempting purchases by underwriters which would have been unnecessary if "at the time of" the purchase meant "before" the purchase, and
>
> (c) that under petitioner's construction the Congressional intent would be evaded and frustrated.

The three decisions below adopting the S. E. C. arguments (Pet. pp. 21-5; 42a-3a; Pet. p. 9) are obviously correct.

3. This case does not afford an appropriate vehicle for review of the question principally argued: should

one *not in fact an insider* immediately prior to the acquisition which brings him over the 10% mark be subject to Section 16(b)? As the record below shows (*supra*, p. 2) G-P was one of the original promoters of K-F and shared control in its management and operations at all times thereafter despite the temporary dip in its holdings below 10%. Indeed a serious question was raised before Judge Kaufman whether G-P and the Kaiser interests were not so closely allied as to constitute a "person" (collectively owning more than 10% of K-F's stock immediately prior to the sale in question) under Section 3(a)(9) of the Act which provides as follows:

> "Sec. 3. (a) When used in this title, unless the context otherwise requires—
>
> "(9) The term 'person' means an individual, a corporation, a partnership, an association, a joint-stock company, a business trust, or an unincorporated organization."

Judge Kaufman adverted to this question but did not have to decide it (Pet. pp. 20, 22, 25). Its continued presence in the case, to say the least, obscures petitioner's point even assuming that the point has any merit.

The Second Reason for Reversal

Petitioner says (Pet. p. 6):

> "The Court below has held that 'under Section 16(b) a "beneficial owner" who buys and sells within the statutory period is to be regarded as a fiduciary who breaches his duty of loyalty (i. e. his duty not to engage in self-dealing) and who, in such circumstances, must account for his profits.'

> "Putting it differently, the Court below has held that a defendant is shouldered with the obligations of an unfaithful trustee upon proof of two facts; (1) that he is an insider and (2) that he bought and sold within a period of less than six months."

Petitioner has not correctly stated the holding of the Court below. Petitioner has omitted the key holding—that plaintiff made out a *prima facie* case that Graham-Paige profited by this transaction in the amount of $434,787.86. The pertinent language of the opinion below is as follows (Pet. 11, 12):

> "The trial judge found—we think correctly—that Graham-Paige's statements of profit in the amount of $434,787.86 sufficed to establish a prima facie case for plaintiff. Significantly, the judge refused to make a finding, requested by defendant Graham-Paige, that there were no profits. But the judge apparently assumed that plaintiff, despite his prima facie case, continued to bear the burden of proving that there were profits and in what amount; therefore, as defendant's proof left the judge uncertain in this respect, he decided for the defendant. So we incline to understand the judge's reasoning as indicated, *e.g.*, by his statement that, 'Plaintiff's prima facie proof * * * has been shown to be unacceptable.'
>
> "If so, we think the judge erred. In *Gratz* v. *Claughton*, 187 F. 2d 46 (C. A. 2) we held that, under Section 16(b), a 'beneficial owner' who buys and sells within the statutory period is to be regarded as a fiduciary who breaches his duty of loyalty (*i.e.* his duty not to engage in self-dealing) and who, in such circumstances, must account for his profits. Elsewhere we have held

that, once a cestui shows a breach of such a duty and prima facie proof of a maximum amount of profits made by the fiduciary, then the fiduciary has the burden of proving to what extent the profits were less than this maximum—especially where the fiduciary's breach is responsible for the difficulty or impossibility of proving the amount with certainty—and that consequently, if the fiduciary's proof leaves the amount uncertain, judgment goes against him for the maximum figure."[4]

Prima facie proof is all that is required by the decisions of this Court cited by the Court of Appeals. Accordingly the decision below involves only the application of well settled principles, does not merit review, and, in addition, is clearly correct.

CONCLUSION

There is no basis for granting a writ of certiorari and the petition should be denied.

Respectfully submitted,

LEWIS M. DABNEY, JR.,
MURRAY C. BERNAYS,
Attorneys for Respondent,
Michael Stella,
165 Broadway,
New York, N. Y.

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[4] In support the Court cited *Perlman* v. *Feldman*, 219 F. 2d 173, 177, 178 (C. A. 2); *York* v. *Guarantee Trust Co. of New York*, 143 F. 2d 503, 517 (C. A. 2); *Phelan* v. *Middle States Oil Corp.*, 220 F. 2d 593, 600-601, 613 (C. A. 2); *President and Directors of Manhattan Company* v. *Kelby*, 147 F. 2d 465, 476 (C. A. 2), *Upson* v. *Atis*, 155 F. 2d 606 (C. A. 2); cf. *Bigelow* v. *R. K. O. Pictures*, 327 U. S. 251, 265-266; *Story Parchment Co.* v. *Paterson Parchment Co.*, 282 U. S. 555; *Package Closure Corp.* v. *Seabright Corp.*, 141 F. 2d 972, 979 (C. A. 2).

APPENDIX "A".

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

Civil Action No. 51-92

MICHAEL STELLA, suing on his own behalf and on behalf of all other stockholders of Kaiser-Frazer Corporation similarly situated,

Plaintiff,

—against—

GRAHAM-PAIGE MOTORS CORPORATION, and KAISER-FRAZER CORPORATION,

Defendants.

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

PRELIMINARY STATEMENT

This is an action instituted pursuant to Section 16(b) of the Securities Exchange Act of 1934 (15 U. S. C. 78p(b)) to recover profits realized by the defendant, Graham-Paige Motors Corporation, from short-term trading in the securities of the Kaiser-Frazer Corporation. The Commission, in view of its statutory responsibilities for the administration of the Securities Exchange Act, submits this memorandum as amicus curiae to express its views upon the questions of construction of the Act raised by the

pleadings. It takes no position with regard to any factual questions which may be placed in issue.

Facts

It appears from the pleadings and affidavits filed in the action that upon organization in 1945, Kaiser-Frazer had a capital structure consisting of 500,000 shares of common stock. Graham-Paige was one of the promoters of the company and received 250,000 of these shares. Due to successive new stock flotations to the public of 1,700,000 shares in September, 1945, and 1,800,000 shares in January, 1946, the 50 per cent Graham-Paige interest in Kaiser-Frazer was reduced to 6¼ per cent. However, on February 10, 1947, an additional 750,000 shares were issued by Kaiser-Frazer to Graham-Paige, bringing its interest in the company up to 21 per cent.

Subsequently, within six months of the acquisition of the 750,000 shares, Graham-Paige sold 155,000 shares of Kaiser-Frazer stock, realizing a profit therefrom. Plaintiff, a stockholder of Kaiser-Frazer brings this action in behalf of the corporation to recover that profit.[1]

Graham-Paige has made a motion for summary judgment on the ground that Section 16(b) itself exempts from the liabilities it imposes transactions by beneficial owners of ten per cent or more of any class of equity security of the issuer if "such beneficial owner was not such both at the time of" the

[1] The precise amount of the profit, apparently, is to be determined at some future time. The method to be followed in calculating it is disputed, but is not placed in issue by this motion.

purchase and at the time of the sale. It is contended by Graham-Paige that this language should be construed to exclude the purchase of 750,000 shares from any computation of profit. Plaintiff contends the exemption is inapplicable to this transaction and resists the motion for summary judgment.

Argument

Section 16(b) provides:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the

> date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

It was designed to provide a deterrent to short-swing trading by insiders. The legislative investigation which led to the adoption of the Security Exchange Act uncovered numerous instances in which managers of publicly-owned corporations obtained information concerning coming events not generally known and who traded in the stocks of their corporations on the basis of this information. In order to discourage this practice Section 16(b) of the Act makes any profit realized from such trading "inure to" the corporation, thus removing all incentive to engage in such activities.

However, two exemptions are provided in the section and the Commission is authorized by rule or regulation to exempt any other transactions "not comprehended within the purpose of" the section. It is upon one of the exemptions included in the section itself that the defendant relies.[2] It provides:

> "This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale . . ."

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[2] The other exemption in the section, providing that acquisitions "in connection with a debt previously contracted" shall be excluded from the liabilities imposed, is not involved in this case.

Defendant reads this as if it provided that, in order to be within the purview of the section, the insider must be "such beneficial owner" *prior to* "the time of the purchase." *At the time of the purchase, i.e.* when the purchase took place, defendant owned substantially more than ten per cent of the stock. It is only if the literal meaning of "at the time of" is ignored and "prior to" substituted therefor that the exemption can be construed to relieve the defendant from liability. That defendant, in his argument, makes this substitution is apparent. In his oral argument he conceded that the sale which reduces an insider's holdings to less than ten per cent should be included in any computation of profits realized under the section. If "at the time of" means "simultaneously with," as we contend, this result follows. However, if he denies that "at the time of" means "simultaneously with" and still maintains that the sale reducing the insider's holdings to less than ten per cent is "at the time" he was a ten per cent holder it must be because he is reading that phrase as synonymous with "prior to."

Moreover, only by including defendant's purchase in the computation of the liability it incurred under section 16(b) can that section be made consistent with the statutory purpose. A person who acquires a large block of stock in a single transaction normally has access to inside information. He necessarily would deal, in the negotiations looking toward the purchase, with either the issuer or an insider holding a large interest in the issuer. In either event he would be in a position to bargain for disclosures not available to the public. It is against abuse of information so obtained as well as of information obtained after representation in management is secured that the section is directed.

This was graphically illustrated during the hearings leading to the adoption of the Act by the frequent references to promoters and market manipulators who were granted interests in large blocks of stock prior to a market rise in the shares and who distributed these shares during the ensuing rise. If, under such circumstances, the purchase is excluded from the calculation of the profits which inure to the corporation, the section would be largely ineffective to prevent one of the prime evils uncovered in the congressional investigation.[3]

The Commission, at least by implication, early recognized that the Congress intended to include such purchases within the scope of the Act. Acting pursuant to the authority granted it to exclude from the operation of section 16(b) such transactions as "are not comprehended within the purposes of Section 16(b)" it promulgated a rule, on June 8, 1935, exempting underwriting transactions meeting certain conditions from the liabilities imposed by the section. Such an exemptive rule would not have been necessary, insofar as underwriters who became 10 per cent owners of the securities underwritten by virtue of their underwriting agreement were concerned, unless section 16(b) is given the literal construction we have suggested.[4] Subsequent amendments of this rule, in 1936 and 1938, did not vary this interpretation. It

[3] See Sen. Re. No. 1455, 73rd Cong. 2 Sess. pp. 55-68. Particularly attention is there directed to the Sinclair Consolidated Oil stock deal, in which a stock market operator was granted a right to purchase 1,130,000 shares of an authorized total of 5,500,000 shares of common stock of the company at slightly above the market price. Within a six months period these shares, as well as some 70,000 others purchased subsequently, were sold at a profit of $12,00,109.41. *Ibid.* pp. 63-65.

[4] The rule is reproduced as Appendix A attached to this brief.

is apparent, therefore, that the Commission has consistently, for 17 years, regarded the purchase by which a stockholder achieved a ten per cent interest in the corporation as subject to the liabilities imposed by the section.[5]

The exemption applies only to transactions of purchase and sale when the stockholder has less than ten per cent of any class of equity securities of the issuer. Thus any purchases or sales made by defendant prior to February 10, 1947, would not be included in any computation of profit. Obversely, the exemption would exclude any sales made after defendant ceased to be a ten per cent holder.

If there is any ambiguity in the language used in the section we believe it must be resolved in favor of a narrow construction of the exemption. As we have shown, and as the courts have repeatedly held, section 16(b) is broadly remedial, in fulfillment of a congressional intent "to establish a standard [of conduct] so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty." *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231, 239 (C. A. 2, 1943).[6] Exemptions excluding transactions from this strict rule of accountability should not be enlarged in the absence of clear and positive proof that the

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[5] See *U. S.* v. *American Trucking Association*, 310 U. S. 534, 549; *Norwegian Nitrogen Products Co.* v. *U. S.*, 288 U. S. 294, 315; *S. E. C.* v. *Associated Gas & Electric Co.*, 99 F. 2d 795, 798 (C. A. 2, 1938); in which it was indicated that the construction of a statute by an agency charged with its administration was entitled to "great weight."

[6] See also *Gratz* v. *Claughton*, 187 F. 2d 46 (C. A. 2).

Congress so intended them to be construed.[7] This general rule of statutory construction is particularly applicable where, as in this case, an enlarged exemption would destroy remedial processes intended to be accomplished by the statute.

Conclusion

For the reasons stated we believe the motion for summary judgment should be denied.

Respectfully submitted,

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Securities and Exchange
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Date: March 1952

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[7] *S. E. C.* v. *Sunbeam Gold Mining Co.*, 95 F. 2d 699 (C. A. 9, 1938); *Spokane & Inland R. R.* v. *U. S.*, 241 U. S. 344, 350.

APPENDIX A (TO SEC BRIEF)

Rule NB2. *Exemption from Section 16(b) of Certain Distributing and Underwriting Transactions.* Any transaction of purchase and sale of a security shall be exempt from the provisions of Section 16(b), to the extent prescribed in this rule, as not comprehended within the purpose of said subsection, upon condition that:

(a) The person effecting such transaction purchases such security, with a view to the distribution thereof, from a person (1) who is the issuer thereof, or (2) who is participating in good faith in the distribution of the same issue of securities and whose ownership of such security has been acquired within six months, directly or solely through other such participants, from the issuer;

(b) Such transaction is effected by a person who is otherwise engaged in the business of buying and selling securities for his own account, through a broker or otherwise, as a part of a regular business; and

(c) If the person effecting such transaction is either (1) an officer or director of the issuer, (2) a firm of which such officer or director is a partner, or (3) a corporation or other person in respect of which such officer or director is an officer, director or beneficial owner, directly or indirectly, of more than 10 per cent of any class of equity security, then other persons who are not specified in clauses

(1), (2) or (3), of this paragraph (c) must have participated in the purchase of such security (or other securities of the same issue) with a view to the distribution thereof, on terms identical with those on which such specified persons have participated and to an extent at least equal to the aggregate participation of all such specified persons.

The exemption of a transaction pursuant to this rule with respect to the participation therein of one party thereto shall not render such transaction exempt with respect to participation of any other party therein unless such other party also meets the requirements of paragraphs (a), (b), and (c) of this rule.

JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

October Term, 1956

No. 164

GRAHAM-PAIGE MOTORS CORPORATION,

Petitioner,

against

MICHAEL STELLA, etc., *et al.*,

Respondents.

REPLY BRIEF OF PETITIONER

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IN THE

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October Term, 1956

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Respondents.

REPLY BRIEF OF PETITIONER

POINT I

A District Court in another Circuit has rendered a decision expressly disagreeing with the majority holding in this case.

The petition for certiorari herein was filed on June 14, 1956. On June 18, 1956, the United States District Court for the Western District of Arkansas, El Dorado Division, Miller, D. J., decided the case of *Arkansas Louisiana Gas Company* v. *W. R. Stephens Investment Co., Inc.*,[1] wherein the Court said:

> "A question is presented as to whether the original purchase of 1,958,189 shares should be used in com-

[1] Not yet officially reported; unofficially reported in CCH Fed. Securities Law Rep., ¶ 90,763, June 28, 1956.

> puting the profits recoverable by plaintiff. In a recent opinion the Court of Appeals for the Second Circuit held that such a purchase should be considered. *Stella* v. *Graham-Paige Motors Corp. et al.*, 2 Cir. 232 F. 2d 299. Judge Hincks, in a well-reasoned dissenting opinion, pointed out the weakness of the majority decision. This court is of the opinion that Judge Hincks' reasoning is correct and that the original purchase should not be considered in computing the recoverable profits."

Thus a District Court in the Eighth Circuit, with full knowledge of the majority opinion in the instant case has agreed with Judge Hincks' dissent upholding petitioner's position on the first question presented by the petition herein.

The undersigned respectfully submits that this is an additional reason which did not exist at the time of the filing of the petition herein for this Court to allow certiorari in this case.

Others also agree with petitioner's contention that the purchase as a result of which a stockholder becomes the owner of more than 10% of any class of an outstanding security is not a purchase made while he is a 10% beneficial owner. Eustace Seligman, in his article in 21 Virginia Law Review 1 (1934) at page 19, *et seq.* says:

> "A person not a director and owning no stock buys more than 10% of a registered equity security. He then sells such security at a profit within six months. Must he account for his profit?
>
> "Section 16(b) of the Act states:
>
> 'This subsection shall not be construed to cover any transaction where such beneficial owner was not

such both at the time of the purchase and sale, or the sale and purchase, of the security involved * * *.'

"The answer to the question depends upon the meaning of the words 'at the time'; do they mean before the purchase or after giving effect to the purchase?

"In the case of the second step, namely, the resale in the illustration given, the words 'at the time' must mean immediately before the resale, for if they mean after giving effect to the resale, then the effect of the quoted language would be to render Section 16(b) practically ineffective since it could be avoided by a single sale of all the stock owned. Accordingly, if the words 'at the time' are to be given the meaning of immediately before in the case of the resale, the same meaning would seem necessary in the case of the purchase. From this it would follow that the transaction under discussion comes within the exception contained in the quoted language."

Charles H. Meyer, a widely known authority on stock market practices, whose analysis of the Securities Exchange Act was considered by Congress (see 78 Congressional Record, p. 11006) in his book "The Securities Exchange Act of 1934, Analyzed and Explained" states at page 112:

"16(b). Stockholder not liable unless he owned 10% of the stock both at the time of the purchase and at the time of sale.

"Let us assume a case where a stockholder owns somewhat less than 10% of the stock. He buys additional stock which gives him more than 10%. Without buying any more, he subsequently sells some of his stock at a profit. He is not liable to the corporation, because he was not a 10% stockholder at the time of the purchase."

So that there is a sharp difference of opinion between Judges Clark and Frank of the Second Circuit and Judges Dimock and Kaufman of the Southern District of New York on one side, and Judge Hincks of the Second Circuit, District Judge Miller in the Eighth Circuit, and Eustace Seligman and Charles H. Meyer on the other.

POINT II

The arguments contained in the brief of the SEC submitted as *amicus curiae* in the District Court upon a motion for summary judgment are untenable.

In its brief (annexed to the respondents' brief upon this petition and submitted on the motion for summary judgment made in 1952) the SEC took the position that a person who acquires a large block of stock in a single transaction would normally have access to inside information, and that he necessarily would deal in the negotiations looking toward the purchase with either the issuer or an insider holding a large interest in the issuer.

In making this argument the SEC completely abandoned the rationale of the statute. The statute is not concerned with the possession or absence of actual inside information. It is a statute which sets an objective and arbitrary rule. One who owns less than 10% is not under the statute and one who owns more is. *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231 (2 Cir. 1943), cert. den. 320 U. S. 751, 88 L. Ed. 448.

A person who owns less than 10% of the stock may actually have inside information, and a person who owns more than 10% of the stock may be without actual inside information. But, the statute is arbitrary. Under it a person who owns more than 10% is *presumed* to have inside information; and conversely, a person who owns less than 10% is not within the statute. The correctness of this position was recognized by the SEC in a brief they sub-

mitted as *amicus curiae* in the case of *Rattner* v. *Lehman*, 193 Fed. 2d 564, when that case was before the United States Court of Appeals. In that brief, which incidentally was written by the same counsel for the Commission who wrote its brief in this case, the Commission said:

> "Section 16(b) declares the provision for the surrender of profits to be 'for the purpose of preventing the unfair use of information which *may* have been obtained' through an inside relationship to the issuer. (Emphasis supplied.) It was intended to operate irrespective of actual proof of abuse of inside information."

In its *amicus* brief the SEC also argued in extension of the statute that the contentions urged by the petitioner herein would act to nullify the statute's effectiveness to prevent one of the prime evils uncovered in the Congressional investigation leading up to the enactment of the statute.

It could as well be said, and, in fact, it was said during the Congressional discussions which led up to the enactment of the statute, that its purpose would be defeated by limiting its application only to persons who own more than 10% of the stock. A 9% stockholder or a 1½% stockholder might very well have just as much access to inside information as a 10½% stockholder. It is not for us or the courts to pass upon the wisdom of the legislation, but merely to apply it as enacted. Many thought that 5% was a proper figure; in fact, that was the figure included in an earlier legislative draft; some thought 2%, some thought 25%. Much can probably be said in support of both a more stringent and more lenient statute, but the problem presently presented is not to agree or disagree with the statute as enacted, but to apply it. As enacted, the statute exempts the transaction in this case.

As was said in *Addison* v. *Holly Hill Co.*, 322 U. S. 607, 617, 618 (1943):

> "Legislation introducing a new system is at best empirical, and not infrequently administration reveals gaps or inadequacies of one sort or another that may call for amendatory legislation. But it is no warrant for extending a statute that experience may disclose that it should have been made more comprehensive. 'The natural meaning of words cannot be displaced by reference to difficulties in administration.' *Commonwealth* v. *Grunseit* (1943), 67 C. L. R. 58, 80. For the ultimate question is what has Congress commanded, when it has given no clue to its intentions except familiar English words and no hint by the draftsmen of the words that they meant to use them in any but an ordinary sense * * * After all, legislation when not expressed in technical terms is addressed to the common run of men and is therefore to be understood according to the sense of the thing, as the ordinary man has a right to rely on ordinary words addressed to him."

Section 16(b) is a statute which established a new and independent cause of action in favor of an issuing corporation not known at common law. The common law does not recognize liability without wrong. Liability is fixed by § 16(b) without regard to actual wrong or wrongful intent. The statute calls for the forfeiture to the issuing corporation—not a party to the transaction—of profits made by a holder of more than 10% of any equity security of the issuer even though no inside information was actually possessed or used.

Statutes of this character which are derogatory of the common law, confiscatory, and punitive in nature must be strictly construed. *Brunswick Terminal Co.* v. *National*

Bank of Baltimore, 192 U. S. 386, 48 L. Ed. 491; *Ross* v. *Jones*, 89 U. S. 81, 22 L. Ed. 730; *Smolowe* v. *Delendo Corporation*, 136 F. 2d 231 (2nd Cir., 1942), cert. denied 320 U. S. 751, 88 L. Ed. 446; *Matter of William F. Davis, Jr.*, 17 T. C. 59; *C. I. R.* v. *Obear-Nester Glass Co.*, 217 F. 2d 56, 58 (7th Cir., 1954), cert. den. 348 U. S. 982, 99 L. Ed. 764, reh. den. 349 U. S. 948, 99 L. Ed. 1274; *Tiffany* v. *Bank of Missouri*, 85 U. S. 409, 21 L. Ed. 862.

To say that Graham-Paige was the owner of the 750,000 shares at the time it bought them is unsound. At the time that Graham-Paige bought the 750,000 shares, it was only a 6¼% stockholder, inasmuch as at that time it only owned 250,000 shares out of an outstanding 4,000,000.

Plaintiff seems to see something strained in defendant's argument that as used in the statute "at the time of" means "immediately before," or "while." There is nothing strained at all about this. When the statute says that the 10% stockholder must be such both at the time of the purchase and sale, it means that he must have occupied that "status" at the time that he undertook to buy and to sell stock of the issuer. It means that he must have had the "relationship" to the corporation of a more than 10% stockholder at the time that he bought and at the time he sold.

When one says that John Doe lived in New York at the time of his death, it means that he lived there immediately before his death. When, in speaking of a bigamous marriage, we say that John Doe was married "at the time" of his wedding to Jane Doe, it means that he already occupied the status of a married man when he was married to Jane Doe. When it is said that John Doe was 21 years old at the time of his induction into the army, it doesn't mean that he was inducted on his birthday, at the very instant which corresponds with the hour, minute and second of the time of his birth twenty-one years before, but it

means, in normal language and reasonable understanding, that he had already attained the status of majority before he was inducted.

There is nothing strained about defendant's interpretation. When the statute says, as it does:

> "This section shall not be construed to cover any transaction where such beneficial owner was not such both *at the time* of the purchase and sale * * *"

it means that it does not apply and shall not be construed to apply to any situation where such stockholder did not already occupy the status of a more than 10% stockholder when he acquired the stock involved. Had Congress meant what plaintiff now contends, it would have been simple to so state. Instead of pointedly including the above exception and interdiction expressly in the statute, Congress could have remained silent on this point if it did not intend that the purchase, by which the "insider" status was created, be exempted from the operation of the statute.

Consider this language of the statute:

> "For the purpose of preventing the unfair use of information, which may have been obtained * * *."

The words "may have been obtained" are in the past tense. It is information which "may have been obtained" that the stockholder is prevented from using to his own advantage in connection with a purchase and sale of stock. This language being in the past tense clearly shows that the statute was intended to operate only where the *status* or *relationship* of a more than 10% stockholder already existed at the time of the purchase and sale involved.

Liability under the statute should not be extended beyond that which Congress in clear-cut language fixed.

The arguments in the Commission's brief amount in substance to a recital of some of the scandals, abuses and

manipulations which preceded the enactment of the Securities Acts of 1933 and 1934. It urges that the purpose of this act can be better accomplished by extending liability thereunder to a situation such as that in the case at bar. Assuming it to be entirely right in its argument, it must be addressed to the Congress. The courts may not amend the statute.

Further in its brief as *amicus*, the SEC argued that if the defendant's contention were correct there would have been no need for the SEC Rule NB2 exempting from Section 16(b) certain distributing and underwriting transactions and has annexed as an appendix to its brief such rule.

The premise upon which the Commission based this argument is fallacious and its conclusion is a non-sequitur. Rule NB2 exempting underwriting transactions is still necessary even though defendant's contention is correct, because without NB2 no one who has acquired the status of a 10% stockholder could buy and sell within six months and retain the profit. Accordingly, without Rule NB2, an underwriter who already was a 10% stockholder of the corporation could not participate in an underwriting of its stock. By complying with Rule NB2, he can.

It is, of course, beyond question that neither an officer nor a director of a corporation could enter into an underwriting of its stock unless Rule NB2 had been established. So here are clear examples that Rule NB2 is necessary even under the defendant's interpretation of Section 16(b).

The Commission argued that because Rule NB2 was amended in 1936 and 1938 and the Commission did not vary its interpretation with respect to its application to underwriting agreements, it follows that the Commission has consistently for seventeen years regarded the purchase by which a stockholder achieved a 10% interest in the corporation as subject to the liabilities imposed by the

section. This argument is not sound. On the argument of the motion for summary judgment, Mr. Myer Feldman, who, in 1952, wrote the brief for the Securities and Exchange Commission, and who advised Judge Kaufman that he had written the chapter dealing with this section which is in the work of Louis Loss dealing with the Securities Act, admitted that this question had never been raised before, and that it was not dealt with in his chapter in that book. The Commission had never previously been confronted with this problem. The Commission pointed to no case and no interpretation, even by it, relating to this question. Mr. Feldman also wrote an article for the Michigan Law Review (1946) of 35 pages, relating to Section 16(b), which shows that the specific question before this Court was not considered.

The Commission's language on its own Forms 6 and 4 clearly indicates that it shared the interpretation of the defendant. Form 6 says: "The undersigned owned directly or indirectly as beneficial owner on ———— immediately *after* becoming ———— of the above issuer * * *." (Emphasis supplied.)

The Commission argued that the only transactions which would be exempted by the language of the statute are those where both the purchase and sale ~~that~~ were made prior to the date when the defendant is alleged to have acquired the 750,000 shares.

If the Commission were right, it would mean that the exception to the statute is entirely unnecessary. The provision upon which defendant relies excepts transactions where a stockholder is not a 10% beneficial owner at *both* ends of the deal, that is, *both* at the time of purchase and sale or sale and purchase, as the case may be. If he were a 10% stockholder at *neither* end of the deal, obviously he would not be under the statute even though it did not contain the exception. What the Commission said, therefore,

is that the language of the exception means nothing and that Congress meant nothing when it said:

> "This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale or the sale and purchase of the security involved."

Perhaps in the course of drafting a statute, a single word without any specific or clear purpose might slip in, or slip out, of the draft, but to assume that Congress inserted in a statute a specific exception and direction as to construction, consisting of thirty-five words, for no purpose at all, is stretching a point.

Although the SEC appeared as *amicus curiae* upon the motion for summary judgment made in 1952 and then submitted the brief now used by the respondent as part of his brief upon this application for a writ of certiorari, it did not appear, nor did it file any brief or take any part in the trial which was held in 1954 or the appeal to the Court of Appeals which was argued in 1956.

POINT III

Respondents' brief creates an erroneous impression.

On page 2 of his brief the respondent states:

> "Within less than six months G-P sold 155,000 shares of this stock realizing a substantial profit which the Court of Appeals held recoverable by the respondent stockholder of K-F for K-F's benefit."

This is incorrect. The Court of Appeals has not held that any profits were realized or that any profits are recoverable.

On pages 8 and 9 respondent quotes from part of the Circuit Court's opinion, but stops short of the following paragraph:

> "However, since it is not entirely clear what the judge would have found—as to whether Graham-Paige discharged its proof-burden—had he read the foregoing, in the interest of justice we remand with directions that he make a specific finding on that issue, in the light of what we have said above."

No such finding has been made by the District Court.

The second question presented for review is clearly stated in the petition, that is, whether in an action brought under 16(b) a plaintiff establishes a case before he has established that the transaction resulted in a profit, and perforce whether a defendant can be properly said to have the obligations of a so-called wrongdoing fiduciary until after the plaintiff has established that a short-swing profit has been realized.

CONCLUSION

This case presents questions of statutory interpretation and involves important questions of Federal law which have not been but should be settled by this Court. Certiorari should issue.

Respectfully submitted,

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JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 164

GRAHAM-PAIGE MOTORS CORPORATION,

Petitioner,

—against—

MICHAEL STELLA, etc., *et al.*,

Respondents.

REPLY BRIEF OF RESPONDENT, MICHAEL STELLA, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

1. Petitioner's quotation from the article of Eustace Seligman in 21 Va. L. Rev. 1, 19-20 (1934), is incomplete, and petitioner is in error in stating that Mr. Seligman agrees with its contention. Immediately following the quoted passage (Pet. Reply Br., pp. 2, 3) is the following:

> "However, the effect of this construction would seem to be contrary to the purpose of the Act. Accordingly, it appears probable that a contrary

> construction would be adopted. Such a construction can be reached and at the same time meaning given to the above quoted language [of Section 16(b)] by taking the view that the intention of the language was to exclude the second sale in a case where 10% is purchased, 5% sold within three months and the remaining 5% a month later. The latter construction of the Act is, it is believed, the only safe one to rely upon."

Mr. Seligman then discusses the fact that this construction would forbid purchase by an underwriter for public distribution of more than 10% of any equity security of a corporation; that a construction forbidding such purchase by underwriters might arguably be called absurd; but that, nevertheless, the risk of such a construction was so great "that no conservative banker would take a chance in the matter. Consequently, there is a pressing need for regulations by the Commission exempting financing both in the case of 10% owners and directors. The spirit of the Act certainly would not be violated by such an exemption."

As Judge Kaufman points out (Pet., p. 24), the section's exemptive rule was adopted shortly after the appearance of the Seligman article.

The SEC has stated in its brief *amicus* (Resp. Br., p. 16) that by the adoption of this rule "the Commission at least by implication, early recognized that the Congress intended to consider such purchases within the scope of the Act."

2. The opinion of Charles H. Meyer (Pet. Reply Br., p. 3) was expressed in 1934 prior to the adoption of the above mentioned rule.

The remaining contentions of petitioner do not merit further discussion.

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